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Governability, Inequality, and the Welfare State

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Economic insecurity and inequality make the governance of political societies and the international order more complex. Reallocating spending from the social commitments of the welfare state to the military budget is thus inadvisable over the long term. Instead, the welfare state should be oriented toward protecting production capacity, especially at a time when the means of production are potentially going to be revolutionized by the emergence of new technologies such as artificial intelligence.

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The hard-right repositioning of the current United States (U.S.) administration under Donald Trump, including recent military threats against North Atlantic Treaty Organization allies, has demonstrated beyond reasonable doubt that the rule-based liberal international order is in deep crisis. The response in Europe revolves around two competing views. On the one hand, there is the opinion that higher defense spending comes at the expense of generous welfare provision that most Europeans hold dear, from public education, healthcare, unemployment insurance, and pensions. On the other hand, there are those who staunchly continue to privilege welfare outlays over military spending. On this side, there is the argument that military might easily triggers armed conflict. A few, such as the Italian minister of interior Matteo Salvini, opportunistically side with the pacifists by professing a hitherto unsuspected support for the welfare state and "peace", even though they make no secret of their admiration for President Vladimir Putin.

Whilst drawing opposite conclusions, neither side of the argument seems to question the existence of a welfare versus warfare trade-off: both take for granted that choosing one over the other is inescapable in the new context of geopolitical strife. This surely begs the question of how domestic welfare provision and the global order are interlinked. Our argument is that economic insecurity and social inequalities make governance of national territories and of the international order indeed more difficult. However, there is no simple relationship between inequality, welfare provision, and governability–if governing means to uphold a social and political order without having to suppress civil unrest. Some of the most unequal countries in the world, for instance the Middle Eastern Organization of Petroleum Exporting Countries, are firmly governed by illiberalism. Others, such as the Council for Mutual Economic Assistance (Comecon) countries of Central and Eastern Europe in the past have broken down even though socio-economic inequalities were comparatively low and welfare provision quite universal.

Despite these caveats, we do believe that in the 21st century: a) equality and governability are inextricably linked; and that b) in liberal democracies, the effect runs indeed from the former to the latter. In this essay, we revisit the path-breaking contributions of Branko Milanović and Thomas Piketty to spell out how their findings can inform our understanding of the relation between global governability and domestic welfare provision, linked by inequality. In hindsight, late-20th century rule-based liberal trade delivered more equality on a world scale, by benefitting the middle class in middle-income countries ("emerging markets"). However, it exacerbated inequality in advanced liberal democracies. The inequalizing trend was most notable in the U.S., enriching those at the top end of the income and wealth distribution.[1] Ultimately, this led to a populist backlash against economic openness and liberal values. Even Europe's high-income democracies, with their fairly egalitarian welfare states, have been affected by a backlash that brought populist leaders with autocratic tendencies into office.

This essay explores the intricacies of global governance, inequality, and the welfare state in three consecutive steps to end on a forward-looking conclusion. We first revisit the work of Branko Milanović, summarized in his famous elephant curve, and of Thomas Piketty, the author of an unlikely blockbuster (*Capital in the 21st Century*). Then we discuss how these economists help us to see why the long-term consequence of rising inequality in recent decades may drive the populist-protectionist backlash

1. A. B. Atkinson, T. Piketty and E. Saez, "Top Incomes in the Long Run of History", *Journal of Economic Literature*, Vol. 49, No. 1, 2011.

of today. Hostile polarization can undermine the governability of countries and of peaceful international relations. We qualify this general conjecture by highlighting that Europe's more generous welfare states, accompanied by market regulation, have consistently delivered more equality than any other world region.

The world is in for greater geopolitical instability, given that a major repair effort of the American welfare state is not in sight. Trump's tariff hikes and tax cuts for the rich try to appeal to nationalistic chauvinism instead, at the cost of the rest of the world. However, European governments, presiding over the largest and richest single market in the world, do not have to act merely as bystanders. By strengthening domestic social cohesion, teaming up with like-minded middle powers such as Canada, Australia, and New Zealand, as well as expanding trade with Africa, Asia, and South America, mindful of their development needs, revitalized European transnational cooperation can reliably put forward a novel compromise between a rule-based economic order and domestic welfare in these dark times.

Inequality in the Liberal International Order

The success and stability of the post-war liberal global order hinged on effective welfare protection, able to keep inequality at bay in rich democracies. The early post-war years registered extensive growth, combined with the expansion of welfare programs, selective openness to trade and financial repression that brought down high debt levels inherited from war times. On the Western side of the Iron Curtain, the Bretton Woods framework ensured formal equality of independent nations, while acknowledging that former colonies needed support for their growth aspirations through the World Bank, that the fixed exchange rate system of the dollar standard needed an International Monetary Fund to deal with unsustainable current account deficits and, later, that the General Agreement on Tariffs and Trade (GATT) organization should allow for orderly protectionism but also institutionalize liberalization. The Bretton Woods framework was highly conducive to Europe's recovery from two devastating wars. Countries of the Global South, however, felt short-changed by the *Pax Americana*. They received no compensation for colonial exploitation. Nor was the GATT the promised trade organization that would stabilize commodity prices and enforce standards of fair trade and investment by the Global North.[2]

2. F. McKenzie, *Rebuilding the Postwar Order: Peace, Security, and the UN-System*, Londres: Bloomsbury Academic, 2023.

The Trente Glorieuses definitely came to an end in the 1970s. In 1971, President Richard Nixon called off the commitment of the U.S. to honor its obligations under the dollar-gold standard. Stagflation, the ratcheting up of unemployment rates and deindustrialization called for a shift to intensive growth, using energy and labor more sparingly by upgrading workplaces with computer technology. Governments in Europe also tried to cut back welfare spending when depressed growth hit their revenues, but these policies met with resistance from voters. A more forward-looking strategy of reviving growth tried to remove barriers to trade more quickly, allow for capital mobility and privatize public enterprises. But this strategy also increasingly constrained domestic welfare policy, especially with respect to taxation. The Global South was exposed to the vagaries of debt finance, volatile exchange rates and capital flight. The Mexican debt crisis in 1982, soon followed by others, led to a "lost decade" in Latin America.

However, this is not the entire story and, to some extent, a view centered on Europe, Latin America and the United States, distorted by nostalgia about the early post-war years when deprivation diminished noticeably and each generation was better off than the previous one. Life expectancy,[3] a robust indicator of living standards and medical progress for all, shows everywhere a spectacularly positive trend –with the exception of Sub-Saharan Africa. Many women got choices over their lives that their mothers and grandmothers never had, from birth control to education, paid employment to political participation. Intensified economic internationalization since the 1980s generated positive welfare benefits for countries, including the Global South, along with social groups in those countries.

What is more, Branko Milanović and his co-author, Christoph Lakner, who had raised the issue of inequality within the World Bank for many years, constructed a striking graph based on household surveys worldwide. It depicted where income growth between 1988 and 2008 had gone in the global income distribution. The "elephant curve" shows that the biggest income gains in those 20 years were made by people in the middle of the global income distribution –the highest point of an elephant's back– and the top end (1% of the global income distribution) –the trunk of an elephant. The lowest gains were made by those around the 80th percentile at the bottom of the trunk and those at the bottom end, its tail. The authors summarize the implication as follows: "The 'winners' were country-deciles that in 1988 were around the median of the global income

3. "Life Expectancy", Our World in Data, October 22, 2025, available at: https://ourworldindata.org.

distribution, 90% of whom in terms of population are from Asia. The 'losers' were the country-deciles that in 1988 were around the 85th percentile of the global income distribution, almost 90% of whom in terms of population are from mature economies".[4] It can therefore explain why economic openness can be a beneficial process not only for the super-rich but also for those in poorer countries, while there is a backlash against economic openness in richer countries.

This led Milanović[5] to continue to defend open borders, even though he acknowledged that high-income countries experienced rising levels of income and wealth inequality. And this is where the path-breaking work of Thomas Piketty (and his many collaborators) gains portent. For Piketty, inequality is the core social problem of early 21st century capitalism, epitomized by the unfettered concentration of income and wealth. In a working paper,[6] Alvaredo *et al.* provide data for 1980-2016, so roughly the time when trade and financial liberalization started until the beginning of Donald Trump's first term in office. In this study, the elephant has turned into a snake that raises its head.

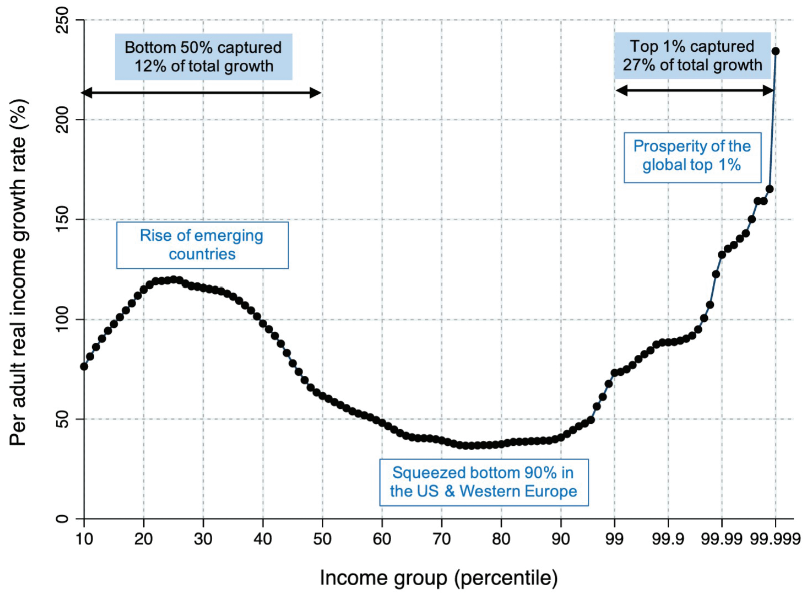
The main point of this figure is this: the bottom half of humanity has indeed gained in income, but this represented only 12% of all income growth that happened over this time and less than half of what the top 1% appropriated. The other 49% of the planet's inhabitants, representing the vast majority of citizens in the United States and Europe (all but the 10% richest individuals), experienced on average hardly any income rise. They kept their real incomes, with a 51% share in income growth. If this is the effect of a more liberal trading order, it seems to be a glass half-full and half-empty story: it made the middle classes of the world's poorer half better off, which makes a real difference to their lives –as Milanović emphasizes; but most of it went to the super-rich –as Piketty highlights in so many ways.

Governability and the Welfare State

Ever-growing inequality and wealth concentration have become a structural component of 21st century capitalism –challenging, according to Piketty, the very viability of liberal democracy. The evidence on global

4. C. Lakner and B. Milanović, "Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession", *Policy Research Working Paper*, No. 6719, World Bank, December 1, 2013.
5. B. Milanović, *Global Inequality: A New Approach for the Age of Globalization*, Cambridge: Harvard University Press, 2016.
6. F. Alvaredo, L. Chancel, T. Piketty, E. Saez and G. Zucman, "The Elephant Curve of Global Inequality and Growth", *WID.world Working Paper*, No. 20, Wealth and Income Database, December 2017.

Figure 1: Total income growth per percentile across all world regions, 1980-2016



Source: F. Alvaredo, L. Chancel, T. Piketty, E. Saez and G. Zucman, "The Elephant Curve of Global Inequality and Growth", *WID.world Working Paper*, No. 20, Wealth and Income Database, December 2017.

Note: The vertical axis shows the cumulative income growth over 36 years for each income group on the horizontal axis (defined as a tenth of the population each, from low to high income). The lowest percentile (0-10%) has been left out since their income is almost zero and the top 10% has been enlarged to show the top 1% up to the 0.0001% of the richest people.

inequality suggests that threats to governability must be found in the dissatisfaction of the 49%, who experienced not much real income growth. It is important to note that this low growth of per capita income holds only on average; the highly educated, entrepreneurial and certain professions did reasonably well in Europe and the U.S., while the less educated, small shop owners or farmers did not. These losers are a big constituency of far-right challenger parties that are also pushing established conservative parties to the far-right. This holds true for both Europe and the United States.

But only the U.S. has so far a hard-right government that is determined and powerful enough to wreck the liberal international order. The agenda of the Trump administration is also the clearest in terms of the difference that this makes to the thrust of policy: an extractive agenda of steep tariffs evades hard choices in fiscal policy, purportedly to protect working-class jobs in the industrial rust belt from Chinese competition, laced with corporate deregulation and tax cuts to America's super-rich; all this to Make America Great Again. It is anti-thetical to social policy for the losers of openness: the rich get richer and the bottom 50% experience an ongoing affordability crisis, inflicted on them by the tariff policy that supposedly protects their jobs.

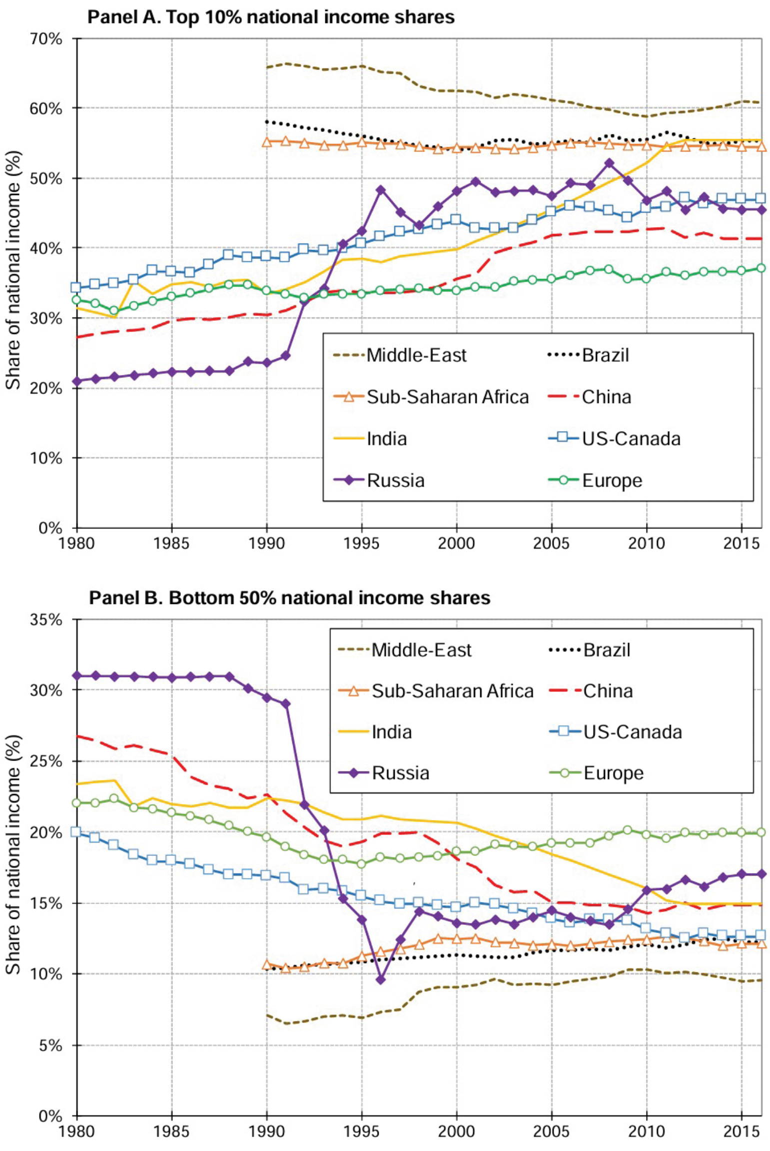
It is therefore tempting to see redistribution and more equality as the obvious way out. But how does the U.S. experience compare to that of other world regions, especially Europe? Alvaredo *et al.* provide an answer.[7]

The panel shows that Europe is the most equal of all world regions: the top 10% of national income earners have the lowest income share and the bottom 50% of earners have the highest share, compared to other world regions. For top earners, it is still a sizeable proportion of around 38% in 2016, which compares with 47% in North America,[8] where the top income share has also risen considerably faster from almost the same level in 1980. The bottom half in Europe got 20% in 2016, lower than in 1980 but rising since 1995, while in North America the decline is continuous to around 13% in 2016. The North-American income distribution is not as extreme as in the Middle East but its bottom half has the same national income share as the bottom half in Sub-Saharan Africa and Brazil; the top income share is the same as that of the top 10% in Russia.

However, we should also admit that this evidence does not suggest that a comparatively equal income distribution is a panacea. All European countries are high-income and, while they have very different welfare systems, national income is more equally distributed, even at the level of market inequality (before taxes and transfers like family benefits). If it were possible to do a comparison across world regions of after-tax income, which includes in-kind public services like free child care or basic health care, it would reinforce the egalitarian frontrunner role of Europe. And yet, European countries have seen a similar ideological backlash against the rule-based international order as the United States. It comes from the far-right, directed at immigrants and international obligations, not from the far-left targeting the rich and tax havens. Far-right parties have become permanent challengers in the North (Sweden and Finland),

7. F. Alvaredo, L. Chancel, T. Piketty, E. Saez and G. Zucman, "The Elephant Curve of Global Inequality and Growth", *op. cit.*
8. *Ibid.*, p. 2.

Figure 2: Top 10% and bottom 50% income shares across the world, 1980-2016



Source: F. Alvaredo, L. Chancel, T. Piketty, E. Saez and G. Zucman, "The Elephant Curve of Global Inequality and Growth", *op. cit.*

Notes: Income here is national income before taxes and transfers, but includes pensions and unemployment benefits.

West (France and Germany), South (Italy and Spain), and the East (Hungary and Poland) of Europe. Far-left parties manage only temporarily a challenge, e.g. as anti-austerity parties predominantly in Southern Europe, and then fragment or disappear. Why is protest in comparatively egalitarian Europe as right-wing as it is elsewhere, not demanding more social democracy and solidarity with the underprivileged but the destruction of institutions that request everybody to respect others' national concerns?

Piketty's tireless reminder that income inequality is driven from the top points to a solution to this puzzle. The exorbitant enrichment of already extremely rich people is the source of a deep malaise that undermines democracy. This economic elite has enormous leverage over governments, as their investment decisions and the location of businesses they own can make or break domestic growth. Hence, these elites feel entitled to actively lobby for more privileges. And as Trump 2.0 demonstrates, they are also prepared to side with an economically reckless government if it promises them to be able to enrich themselves further, unfettered by considerations other than their self-aggrandizement. The change in media technology, usage and ownership also gives them platforms to spread their libertarian messages, even as they build business empires using public infrastructure and lavish government subsidies, such as Jeff Bezos's Amazon and Elon Musk's Tesla. Top income gives political power and vice versa.

What the evidence therefore suggests is that relative equality of high living standards is important but not sufficient for social peace that makes countries and groups of countries governable.

Supporting Governability through Redistribution

For Thomas Piketty, Gabriel Zucman and others, progressive hikes in taxation of wealth, capital, and international transactions, targeting the top 10% of the wealth and income ladder, are therefore imperative.[9] We agree with these two economists on greater tax progressivity and reining in harmful tax competition. However, their own diagnosis of the detrimental political effects of extreme income and wealth concentration should tell them that governments, challenged by shrink-the-state populism, will not

9. K. Clausing, E. Saez and G. Zucman, "Ending Corporate Tax Avoidance and Tax Competition: A Plan to Collect the Tax Deficit of Multinationals", *SSRN eLibrary Working Paper*, January 2021; T. Piketty, "Billionaire Taxation and Wealth Redistribution: A Personal View", *Working Paper*, No. 20, World Inequality Lab, September 2025.

manage to pursue such a tax-the-rich agenda. Piketty[10] realizes that public support will be necessary to tax the "ultra-wealthy", starting with a 2% tax on billionaires that would legitimize taxing millionaires and all the way down, progressively.

We suggest another way. Piketty's advocacy to radically "transcend" 21st century capitalism reveals a misunderstanding of the *modus operandi* of the welfare state. The diversity of European experiences is instructive in this regard. The post-war welfare state provided West-European workers and their families with insurance against capitalist market volatility through income protection in the advent of unemployment, sickness, and old age, while job protection and living wages, either legislated or collectively negotiated, significantly improved working conditions. In addition, access to education and healthcare became universal, greatly contributing to curbing inequality. With respect to the post-1980s politics of rising inequalities, Piketty focuses quite selectively on the U.S. and the UK, where inequality indeed increased dramatically when taxation became less progressive after the 1980s.

However, the Northern European experience shows that progressive outcomes can often be achieved more effectively through egalitarian social spending than progressive taxation.[11] When we include public education and healthcare, the modern welfare state since World War II is arguably the greatest equalizer of all time in the bottom half of the stratification ladder. Each generation's increasing subsidies to the education of their offspring strongly reduce later inequalities by improving future earning power. The effects of welfare policy play out over many years. Their long-term redistributive impact thus requires much wider consideration of data than those confined to income redistribution and taxes.

Over the past decades, a wave of social reform has swept across the advanced industrial world. The American experience has largely been one of policy drift, the incipient erosion of social protection by not updating existing welfare programs to new needs. Arguably, many European countries have avoided U.S.-style policy drift by making welfare programs more universally available and activating in response to the changing nature of social risks. These welfare states can give people not only the means to recover from sickness, to change jobs if the old disappear or degrade to "feeding the machine",[12] and to retire at an age that allows

10. T. Piketty, "Billionaire Taxation and Wealth Redistribution: A Personal View", *op. cit.*
11. P. H. Lindert, *Making Social Spending Work*, Cambridge: Cambridge University Press, 2021.
12. J. Muldoon, M. Graham and C. Cant, *Feeding the Machine: The Hidden Human Labour Powering AI*, Edinburgh: Canongate, 2024.

them to have a meaningful life still. It also allows one to learn new skills and to reconcile family care with pursuing a career, while or after intensive carework for children or elderly parents.

At its best, social safety nets give citizens a sense of control over their lives even when adversity hits or economic-technological change is fast and disruptive. At its worst, it reinforces the pressures of markets, does not leave people any agency and dignity. In order to strive for the better, it has to constantly change and help people to adjust. But activating social policies –from education, unemployment and sickness benefits to reintegration training– must be accompanied by market regulation that shapes the extent and nature of adjustment requested from citizens.[13] Without such market regulation, social policy interventions resemble walking up a downward escalator, driven by capitalist market forces. Capitalism has to be saved from itself, since sustainability in human and ecological terms is not a built-in feature.

European governments have, on the whole, understood this, as shown in Figure 2 above –market income inequality is lower than anywhere else. The escalator was running fast since the 1980s, partly because democratically elected governments decided that more rapid economic and technological transformation must be allowed if living standards in Europe were to keep up. This diagnosis was in principle correct. But combined with a series of crises that Europe was going through –and still is–, we should not be surprised that an increasing share of voters is exhausted and exasperated.

European governments are told today, again, that they must embrace the disruptive innovation of Artificial Intelligence (AI), in particular by the Draghi report.[14] The social policy interventions this report considers are all about retraining the workforce for deregulated markets. We think that, on the contrary, it is a supportive welfare state that allows capitalism to constantly evolve because social safety nets give people assurances if negatively affected. Europeans have a high standard of living, if life expectancy and general health are a robust measure of it, in contrast to the United States. And Europeans have this higher standard of living with less material impact on a planet that has reached its carrying capacity. This has kept European countries on the whole more governable despite similar symptoms of hard-right populism that governs the United States

13. A. B. Atkinson, *Inequality: What Can Be Done?*, Cambridge: Harvard University Press, 2015, p. 120.
14. M. Draghi, “The Future of European Competitiveness”, European Commission, September 9, 2024.

these days. Growth harnessed by the need for social buffering and mindful of the destructive impact on the Earth's system is bound to be lower. Europeans should consider it as the cost of insurance for a livable future.

Going Forward

Coming back to the uneasy relationship between welfare and warfare, and liberal democracy and global order in the 21st century, that we started out with, the first lesson to draw is that dismantling the welfare state to make way for military spending is bad economics. An effective welfare state provides public goods that the market economy undersupplies, such as education, childcare, health, affordable housing, infrastructure, and research and development. In 21st century advanced economies and their aging populations, the return on good skills is what matters most. Especially important are family-friendly policies that foster career continuity and skill development, particularly for mothers, which indirectly bolster children's cognitive and social skills, in terms of valuable educational investments. In fiscal terms, the more generous family policies are, the higher the budget revenue reaped from increased female employment.[15] Going forward, keeping the welfare state on a stable fiscal footing will definitely become more difficult as the number of elderly people rises relative to the working adults who pay for it.

The specter of demographic aging is admittedly more grim for Europe than for the U.S. In order to "outgrow" adverse demography, the average income of (future) workers should hence increase at a faster pace than that of the growing elderly population. Sadly, this is not happening in Southern Europe. In Northern Europe, where the welfare state is robust and, yes, expensive, the employment rate is already much higher than in the United States. AI can play a constructive role here in that it could free up low-intensity care work for more stimulating and gainful work, or to make repetitive medical services more efficient, like screening of x-rays. This means finding non-disruptive uses for a path-breaking innovation, when we cannot be sure where the new path will lead.

Since the 1980s, high-quality education and vocational training have correlated with improved employment and reduced poverty among young adults, nurturing a skilled labor force for knowledge-based sectors facing downward shortages because of adverse demographics. Active-labor-market policies reinforce employment participation through rehabilitation and training, whilst reducing unemployment and poverty.

15. A. Hemerijck, *The Uses of Social Investment*, Oxford: Oxford University Press, 2017.

Finally, active aging, including late-career training, flexible retirement, and long-term care, prolongs dual-earner careers. The so-called "social investment" welfare states have largely paid for themselves when they increased productivity and output in three ways: bringing more people into paid work, making people in paid work more productive, and keeping people in paid work for longer.

Also, redistribution, when done properly, can raise economic performance: by ensuring that no one's potential is wasted, by breaking the intergenerational transmission of crippling poverty and deprivation, by easing the constraints that force poor citizens to take desperate decisions. All in all, the modern social investment welfare state can no longer be understood as a trade-off between equity and efficiency, but increasingly in terms of positive externalities. Also, modern warfare relies on the good skills that a social investment welfare state provides.[16]

Still, voters may ask who benefits from this beneficial relationship between the economy and welfare through social investment? The challenge ahead is that AI may do to skilled professions what computers and automated assembly lines did to manufacturing in rich countries. They allowed high-quality production processes to be relocated to countries with a less trained workforce at a much lower price. Now, lawyers, accountants, consultants and economists with their quantitative skills may all experience steep competition from a non-human competitor. These middle-class voters may be even more vocal than the blue-collar workers are today after populists channeled their anger and grievances into a welfare chauvinistic, nationalistic direction.

Perhaps it leads to more solidarity, when it is essentially a lottery that draws a ticket for in-work or out-of-work, performed by an algorithm. Yet, social policy-makers are well advised to think of how social investment can support the transition into a world of fewer middle-range qualified service jobs.[17] Does the welfare state have to become a major employer by providing personal services rather than transfers, an idea discussed for some time? Should variants of a basic income for everyone be considered? Alternatively, does the public sector have to give a job guarantee at the living wage? Does the tax system have to rely on corporations and their assets rather than employees and their income? The goal would be to give citizens the prospect of a meaningful life in which they

16. A. Hemerijck and M. Matsaganis, *Who's Afraid of the Welfare State Now?*, Oxford: Oxford University Press, 2024.
17. A. B. Atkinson, *Inequality: What Can Be Done?*, *op. cit.*

have choices, rather than being the more or less lucky members of an enigmatic system.

Turning to the supranational level, can an effective welfare state, by substantiating the principles of individual liberty and political equality, with positive freedom and a commitment to economic security and human betterment, help sustain liberal democracy and international peace? Achieving higher levels of defense spending on a ticket of welfare retrenchment is both economically and politically self-defeating. A fully-fledged recovery of the liberal order will ultimately depend on a turn-around in welfare provision in large parts of the world, beginning with the United States. But also, China's growth model is in need of a social investment impetus, with expanding access to affordable childcare and cash benefits to younger cohorts to revive consumption and counter deflation, allowing them to start a family if they so wish. In light of the irreversible extent of world market inter-dependencies and its concurrent external vulnerability for national economies, the European Union should champion international cooperation, for reasons of popular legitimacy, on a ticket of "inclusive growth". The Organisation for Economic Co-operation and Development thus characterizes growth that provides opportunities for jobs, skills, and healthcare to all segments of the population while distributing the dividends of prosperity fairly across the entire stratification ladder. And even if in the short run the need to deter aggression and protect our freedoms will limit the fiscal space available for ambitious social reform, in the medium and longer term the defense vs welfare trade-off does simply not apply: far from consuming scarce resources that might be better deployed to meet more pressing needs, a well-funded welfare state makes a crucial contribution to the resilience of liberal democracy and international cooperation.